WASHINGTON TAX NEWS

Potomac Law Tax Newsletter— August 2017 **Susan Rogers**

The House and Senate were scheduled to start their several week **August recess** on July 28th, but Senate Majority Leader McConnell (R-KY) announced that the Senate will extend the legislative work period into mid-August to allow time to focus on health care reform, nominations, and other legislative priorities, although the failure of the health care reform effort may take that issue off the agenda. The recess could also be affected should the White House consider the possibility of recess appointments that are controversial with Senate Democrats reportedly ready to prevent the Senate from procedurally recessing.

The House Budget Committee approved a **FY 2018 concurrent budget resolution**, which summarizes broad spending cuts and revenue targets for the next fiscal year, but the full House did not vote on this prior to leaving for the August recess. The resolution includes **reconciliation instructions for the Ways & Means Committee to report a comprehensive tax reform bill** and a broad policy statement on tax reform calling for simplification, lower marginal rates for individuals and corporations, consolidation of tax brackets, repeal of the AMT, and a transition to a more competitive system of international taxation. Without approval of this resolution by the House and Senate, Congress cannot move to advance tax reform using the budget reconciliation process.

For more information on these issues, please contact Susan Rogers at srogers@potomaclaw.com or 202.492.3593.

In a joint statement issued July 27th, the White House and Congressional leaders outlined several broad tax policy goals and stated that "the time has arrived" for the tax-writing committees to draft legislation. The intention of this statement is clear – the White House wanted to pivot attention from the failed health care reform effort in Congress and show progress on a key issue that is important to the business community before the August recess.

Susan Rogers

In This Issue

The White House and Congress

Treasury Secretary Mnuchin faces a September 29th target date for achieving an **increase in the federal debt ceiling limit** as stated in a letter sent to Congress, since Congress has not yet acted on legislation Failure to raise the limit could lead to the US failing to pay its obligations and potentially defaulting on US debt. There continues to be uncertainty about whether the Administration's position on this legislation will align with Mnuchin's view that the legislation should be "clean" and not include spending cuts or align with Office of Management and Budget Director Mulvaney's view that it should include additional spending cuts and budget changes.

Congress has not made much progress on the **12 appropriations bills** due to be approved by the start of FY 2018 on October 1st. The House approved a $789 billion defense spending package that includes what GOP leaders have called a $1 billion "down payment" for Trump's border wall. The four-bill package now will go to the Senate, where it is unlikely to pass without changes. The Senate is moving even more slowly and has moved only two bills out of the Appropriations Committee.

In an effort to unite their party and re-energize their message to voters prior to the 2018 mid-term elections, House and Senate **Democrats released a new economic agenda** titled "A Better Deal" with the goals of attacking Republican tax reform goals as benefiting the wealthy, limiting large corporate mergers, and increasing wages.

Treasury and the IRS — IRS Targets Regulations for Repeal and Modification

The IRS issued Notice 2017-38, which identifies **eight regulations that the Treasury Department intends to modify or repeal**, including regulations on debt equity, property transfers to foreign corporations, and certain estate tax rules. This action followed from Executive Order 13798, issued on April 21st that instructed the Treasury Secretary to review all "significant tax regulations" issued on or after January 1, 2016 and to submit a 60-day interim report identifying regulations that impose an undue financial burden on US taxpayers, add undue complexity to the federal tax laws, or exceed the IRS's statutory authority. Out of the 105 temporary, proposed and final regulations issued during that period, 52 were deemed to be potentially significant, and 8 were targeted for action, although none were deemed to exceed the IRS's statutory authority.

A final report recommending specific actions to mitigate the burden imposed by the regulations identified in the interim report is required by September 18, 2017. Comments regarding whether the regulations should be rescinded or modified (and how they should be modified) are due by August 7, 2017. The full list of regulations to be modified, replaced or removed is:

- Proposed regulations under Code section 103 on the definition of political subdivision
- Temporary regulations under Code section 337(d) on certain transfers of property to regulated investment companies (RICs) and real estate investment trusts (REITs)
- Final regulations under Code section 367 on the treatment of certain transfers of property to foreign corporations
- **Final and temporary regulations under Code section 385 on the treatment of certain interests in corporations as stock or indebtedness (with a notice issued July 28th delaying documentation rules for one year)**
- Temporary regulations under Code section 752 on liabilities recognized as recourse partnership liabilities
- Final regulations under Code section 987 on income and currency gain or loss with respect to a section 987 qualified business unit
- Proposed regulations under Code section 2704 on restrictions on liquidation of an interest for estate, gift, and generation-skipping transfer taxes
- Final regulations under Code section 7602 on the participation of a person described in Code section 6103(n) in a summons interview

On July 20th, the Senate Finance Committee unanimously **approved the nomination of David Kautter to be the Assistant Secretary for Tax Policy** at the Treasury Department. A vote by the full Senate has not yet been scheduled. During the committee questioning, Kautter stated that "we can get tax reform over the finish line," and that he believes that all issues should be "on the table." He also commented that he believes that tax reform should be revenue-neutral using dynamic scoring; that eliminating the interest deduction altogether is not advisable; that there should be lower tax rates for pass-throughs while acknowledging the issue of taxing personal service income at a lower pass-through rate; and that the US should continue to participate in the OECD Base Erosion and Profit Shifting (BEPS) project.

The SFC held a **hearing on "Comprehensive Tax Reform: Prospects and Challenges,"** which featured a panel of former Assistant Treasury Secretaries for Tax Policy. SFC Chairman Hatch was asked whether the SFC would hold a hearing once a specific tax reform plan has been released, and he said, "I would like to but I don't know."

In a joint statement issued July 27th, the White House and Congressional leaders outlined several broad tax policy goals and stated that "the time has arrived" for the tax-writing committees to draft legislation with the goal of "a plan that reduces tax rates as much as possible, allows unprecedented capital expensing, places a priority on permanence, and creates a system that encourages American companies to bring back jobs and profits trapped overseas." The controversial Border Adjustment Tax (BAT) proposal which would have imposed a 20 percent tax on all imports while exempting exports has been dropped from consideration.

The "Big Six" tax reform meetings have involved Treasury Secretary Mnuchin, National Economic Director Cohn, Senate Majority Leader McConnell (R-KY), House Speaker Paul Ryan (R-WI), SFC Chairman Hatch (R-UT) and W&M Committee Chairman Brady (R-TX), and all signed the joint statement. House Speaker Ryan has indicated that the current goal is to include permanent tax changes while using temporary changes when necessary to align with budget procedural rules. While tax rate cuts are more likely to be permanent changes, changes to business expensing rules may be temporary.

The Failure of Health Care Reform and the Prospects for Tax Reform

In the run-up to the August recess, Senate Republican leadership committed to a series of votes on the Senate Floor on **health care reform** – an effort that appeared destined to fail with several Republican Senators declaring their opposition to various bills that were broadly described. Why would Senate Majority Leader McConnell go through this exercise?

Some in Washington suggest that his goal is to get past health care reform as an issue so that he can move on to **tax reform** while demonstrating that he responded to the White House and others in the Republican party that an attempt was made to deal with the health care reform issue before abandoning it. It has been suggested by some Republicans that tax reform will be easier with the failure of health care reform because the party will have to show success on some key issue prior to the end of the year.

After failure to approve any of the bills on health care reform as detailed below, Senate Majority Leader McConnell said, "This is clearly a disappointment. It's time to move on."

Health Care Reform

On July 25th, the Senate voted 51-50 in favor of a motion to begin debating the repeal of the Affordable Care Act, with two Republican Senators – Susan Collins (R-ME) and Lisa Murkowski (R-AK) -- voting against the motion and Vice President Pence casting the tie-breaking vote. The Senate then began to take a series of votes on various proposals in an effort to pass some form of legislation that would allow the Senate to move to conference with the House on this issue.

The Senate voted 43-57 against the Better Care Reconciliation Act, which was the Republican leadership's reform bill with additional language from Senator Cruz (R-TX) and Senator Portman (R-OH). It is notable that this version of the bill retained the 3.8 percent net investment income tax on high income households. Then the Senate voted 45-55 against an amendment to repeal major parts of the Affordable Care Act in two years without a replacement. The Senate then moved to vote on the "skinny repeal" bill that included repeal of the individual and employer mandates and the medical device tax, but that also went down to defeat late on July 27th when Senator McCain (R-AZ) joined Senators Collins and Murkowski in voting against the bill.

Tax Reform

The joint statement from the "Big 6" was designed to show a unified commitment to achieving tax reform in 2017, but after weeks of meetings attended by Congressional leadership and key Administration officials, the document was even shorter than the one page set of principles released in April. There are still no details or policy specifics other than the abandonment of the BAT, which leaves a huge question about how to pay for the significant tax cuts that have been promised.

The statement indicated that the process has now been handed back to the two tax-writing committees by stating "our expectation is for this legislation to move through the committees this fall, under regular order, followed by consideration on the House and Senate floors." It is expected that committee and Treasury staff will be working in August to draft legislation that will include policy specifics that will emerge in September when Congress returns as a unified product to be addressed by both the House and Senate.

A public campaign to energize support for tax reform is planned for August with House Republicans planning to talk about the issue in their home districts during the recess while a range of conservative grassroots groups has been meeting with the Administration communications and political staff. The Business Roundtable is planning a multi-million-dollar national television and radio campaign in favor of tax reform.

Tax Reform Update (continued)

Tax Cuts

The joint statement states that permanent tax changes are a priority, but this may leave room for the tax reform package to be more limited than comprehensive reform and focus on tax cuts resulting in a bill that is not deficit-neutral. This approach could, however, run into problems with respect to the current House budget resolution, budget reconciliation rules, and Senate pay-as-you-go rules.

White House officials are considering an alternative strategy of pursuing a short-term tax cut if the effort to pursue comprehensive tax reform is not able to advance in the fall – an idea that has been advocated for by Trump campaign advisors, Lawrence Kudlow and Steven Moore. Treasury Secretary Mnuchin and National Economic Council Director Cohn still appear to prefer a broader plan that would lower rates while eliminating certain tax breaks to offset the cost. Reports have been that no decisions have yet been made by the Administration on whether tax reform must be revenue neutral and whether the tax cuts would be permanent or temporary, and the joint statement does not clarify these issues.

International Issues

The OECD released the **2017 edition of the OECD Transfer Pricing Guidelines** for Multinational Enterprises and Tax Administrations primarily reflecting changes resulting from the OECD BEPS project.

The OECD Committee on Fiscal Affairs released the **draft contents of the 2017 update to the OECD Model Tax Convention** prepared by the Committee's Working Party 1. The update has not yet been approved the Committee on Fiscal Affairs or by the OECD Council, although significant parts of the 2017 update have been previously approved as part of the BEPS package. Comments are requested with respect to certain parts of the 2017 update and should be submitted by August 10, 2017.

The OECD released **revised discussion drafts on the attribution of profits to permanent establishments (PEs) and transfer pricing guidance on the profit split method**. Both replace earlier drafts published in July 2016, and comments are due by September 15th. The PE discussion draft is in response to Action 7 of the BEPS plan and examines the interaction between Article 7 of the OECD Model Treaty (attribution of profits to PEs) and Article 9 (associated enterprises with respect to dependent agent PEs). The second discussion draft on profit splits outlines when the method is the most appropriate transfer pricing method and how profits should be split.

The **European Commission** released a proposal for a council directive that would require reporting and **disclosure of aggressive cross-border tax planning schemes** that will be submitted to the European Parliament for consultation and to the European Council for adoption. The directive requires lawyers, accountants, banks and other financial consultants, called intermediaries, to report international arrangements they design or promote within five days of advising their clients on the arrangements. The reporting obligation to tax authorities falls to the taxpayers themselves if the advisers are either outside the EU or are bound by professional rules protecting client confidentiality.

For additional information and advice on these issues, please contact:

Susan Rogers, Partner
Potomac Law Group, PLLC
1300 Pennsylvania Avenue, NW, Suite 700
Washington, D.C. 20004
202.492.3593
srogers@potomaclaw.com

Susan Rogers has 30 years of experience in the tax policy field in Washington including several years as Majority Tax Counsel to the House Ways & Means Committee and extensive experience managing global tax issues for a Fortune 100 multinational. Ms. Rogers' practice focuses on providing information and strategic advice to clients on US and international tax policy issues and advice on how to manage tax policy risks.